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Supreme Court of the United States

OCTOBER TERM, 1960

No. 230

MEMPHIS A.F.L.-C.I.O. LABOR COUNCIL, ET AL., *Petitioners,*

vs.

CITY OF MEMPHIS, ET AL., *Respondents*

On Petition for Writ of Certiorari to the Supreme Court of Tennessee

BRIEF OF CITY OF MEMPHIS AND MEMPHIS LIGHT, GAS AND WATER DIVISION IN OPPOSITION

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QUESTION PRESENTED

Where the governing body of a city, in prescribing an increase in electric rates for its municipally-owned utility, admittedly acts pursuant to valid statutory authority and without any charge of actual fraud, and where the objectors' complaint is based solely upon the contention that the increase is unnecessary, does such a complaint raise an issue as to the violation of federal Constitutional rights?

STATUTE INVOLVED

Chapter 381, Tennessee Private Acts of 1939, sections 7, 17 and 19, which authorize and empower the City to fix and to change electric rates to be charged by the municipally-owned utility, and which require that certain minimum revenue requirements be met at all times, and which set forth the purposes for which revenues shall be expended. The applicable sections are set forth in the Appendix to this Brief.

STATEMENT OF THE CASE

This case involves an increase in electric rates averaging 18.5%, prescribed by the Board of Commissioners of the City of Memphis for its municipally owned utility, the Light, Gas and Water Division, hereinafter called "Division", effective December 29, 1959. The increase in rates was necessitated by the higher costs to be experienced in the operation of the City's new steam electric generating plant, as compared with the low-cost power purchased from the Tennessee Valley Authority prior to the expiration of the City's contract with it in 1958. The steam generating plant, which had to be built to replace the Tennessee Valley Authority as the City's source of power, was finally completed late in 1959.

In late November, 1959, the officials of the Light, Gas and Water Division announced that an increase in electric rates designed to produce an increase in revenues of approximately 20% was presently necessary. (Appendix C, pp. 13-15, Petition for Certiorari).

This decision was reached upon consideration of the recommendations of Black and Veatch, a nationally known independent consulting engineering firm which had been engaged in a study of the Division's rate structure for approximately three months. (Id.)

The Division thereupon initiated the procedures for effectuating a rate increase in accordance with Chapter 381 of the Private Acts of Tennessee of 1939. No contention is made that the procedures provided in said Act were violated in any way.

Although the Private Act does not require it, the City Commission for the first time in its history initiated a public hearing at which the Division presented testimony and exhibits; including the final report of Black and Veatch, Consulting Engineers, on its study of the Division's rate structure (Appendix F, p. 19, Petition for Certiorari; R. 557-558). The hearings began December 22nd and continued through December 23rd, and were concluded on December 29. (Id.) Testimony, statements, studies and exhibits both for and against the proposed increase were considered. (Id.)

Included in the evidence presented to the City Commission by the Board of Light, Gas and Water Commissioners were the following items:

(1) President Morton of the Division presented a rate study made by the Division indicating a deficit in revenues for 1960, at the old rates, of $6,041,902. (R. 96; Exhibit C to Application for Approval of Changes in Rates)

(2) Morton testified there was no way of curtailing expenses or increasing revenues to make up the deficit without a rate increase (R. 97); that such increase was necessary to keep the Division in sound financial condition (R. 98f; and that even with the increased rates requested, there would remain a deficit for 1960 of nearly $600,000. (R. 99, 100)

(3) Albert P. Learned, the expert witness from the firm of Black and Veatch, consulting engineers, testified that the old rates would result in a deficit of $5,914,000 for the year 1960 (R. 126); and

That the Division could not meet the requirements imposed by the City Charter (Chapter 381, Private Acts, 1939) at lower rates than those suggested by the witness, which were the rates adopted (R. 138-139, 140-141)

(4) A complete and intensive 31/2 month study of the Division's electric rates (Exhibit D to Application entitled "Report on Electric Rates, Electric Division, Memphis Light, Gas and Water Division") by a staff from Black and Veatch, consulting engineers, showed:

(a) Operating expenses would increase substantially in 1960 and thereafter as compared with 1959 and prior years (Table 7).

(b) Gross income at the old rates would be insufficient to pay operating expenses and interest on indebtedness of the Electric Division. (Table 8)

(c) Additional revenue of $5,914,000 would be required for 1960 in order to fully meet operating expenses, interest on debt, principal payments on debt, and payment to a reserve fund required by bond covenants (Table 8, Table 22).

(d) Net electric revenues for 1960 at the old rates would not be sufficient to meet the requirements of the covenants underlying the $163,245,000 Electric Division bond issue (Table 9). . .

(e) A blanket percentage increase to all classes of customers would not equitably distribute the

cost of service among classes, and the modified rate structure did accomplish this, with slight advantage to residential customers over other classes (P. 27, Table 21).

(f) With the new rates in effect during all of 1960, the Electric Division would still show a small deficit for that year, which would be balanced by a small surplus in 1961 (Table 22).

(5) The bond attorney from the firm which gave the opinion as to the validity of the Electric Division's $163,245,000 bond issue testified that the revenues for 1960, at the old rates, as shown on the Black and Veatch report, would be inadequate for the purpose of meeting the obligations of the City under the covenants of the Bond Resolution or the City Charter, (R. 149, 153) and that revenues from the new rates would comply with both legislative acts (R. 155).

(6) The National Director of the Utilities Division of Ernst and Ernst, national firm of certified public accountants, testified that the Electric Division at year end would have available funds in an amount no greater than that which would be required for working capital, for highway relocation, special construction projects and a contingency for major uninsurable casualties (R. 513-518).

Increased rates were adopted pursuant to a finding that:

> "[T]he increases proposed by the Memphis Light, Gas and Water Division are necessary in order that said Division and the City of Memphis perform their obligations under Chapter 381 of the Private Acts of 1939 and the Bond Resolution

> adopted by the Board of Commissioners of the City of Memphis on November 27, 1956, and to maintain the Division's sound financial condition." (Appendix F, p. 19, Petition for Certiorari; R. 557-558)

The petitioners, Memphis A.F.L.-C.I.O. Labor Council and its sixteen individual members, have never claimed that there was any actual fraud committed by the City or Division. The gist of petitioners' complaint, as stated in their petition herein, is that the increased revenues are unnecessary in that they will be used

> "for such novel, unauthorized and arbitrary purposes as 'to maintain sound financial condition,' pay millions into the City treasury for general municipal purposes as a 'tax equivalent,' and accumulate cash through excessive depreciation sufficient to begin construction of 'a fourth generating unit' (Appendix, pages 13-14), converting the city-owned utility into a source of substantial city revenue, contrary to statute and constitutions." (Petition for Certiorari, p. 3)

For a city to maintain itself in sound financial condition may in these days be "novel", but it is not yet unconstitutional. The remaining elements of petitioners' charges, even if true, would raise no federal constitutional issue. The governing statute, Chapter 381 of the Private Acts of 1939, expressly provides for payment of tax equivalents to the City (Section 19 (4)), for use of a reasonable surplus account "for extensions and improvements to the light plant or system" (Section 19 (5)), and for payment into the City Treasury of a return on investment not to exceed 6% (Section 19 (6)).

The fact is, however, that the increased rates will provide no margin for accumulating cash through a depreciation reserve for major additions to plant, but only for normal "renewals and replacements."[1] Furthermore, the increased rates will provide for no return on investment to the City, although the applicable statute would permit a 6% return.

The "Question Presented," as stated by petitioners, (Petition for Certiorari, p. 3), is whether courts have jurisdiction to declare rates "unconstitutional" and to prevent a city from "arbitrarily" fixing "unfair, exorbitant rates."

The Tennessee courts never reached that question, because they found no factual allegations in the pleadings, nor evidence in the record, to support the conclusion that the rates were unconstitutional, unfair, or exorbitant or that the City acted arbitrarily.

The Labor Council's bill filed in the Chancery Court of Shelby County sought a "full and independent judicial consideration of the facts and law upon which their claim of right is predicated" (R. 2) and prayed that Court to "review the proceedings of the respondent Board of City Commissioners and hear such other evidence as either party may desire to introduce," and to order the City Commission to "reverse and set aside

[1] The Report on Electric Rates by Black and Veatch states on page 35:

> "Funds in the Renewal and Replacement Fund are developed from depreciation accruals. Accruals shall be at reasonable rates of depreciation on all classes of property less the principal payments for the same fiscal year on the bonded indebtedness. It is estimated that there will be no balance in this fund as normal additions and replacements of property amount to $6,000,000 to $7,000,000 each year."

its approval of the increased electric rates" and to order that they be "suspended permanently." (Appendix I, pp. 25, 26, Petition for Certiorari).

The Tennessee Court of Appeals held:

(1) The relief sought by petitioners, invoked exercise by the Chancery Court of a power to *fix rates* for electric power service in the City of Memphis, which power that Court did not possess;

(2) The conclusion stated in the bill that the rates were "unjust, unfair, unequal and discriminatory" was not substantiated by any factual allegations; and

(3) A review of the entire record, including the transcript of the hearing before the city Commission, revealed nothing which would warrant a finding that the City or Division officials had "acted unjustly, unfairly, illegally or discriminatorily in the fixing of the rates and charges for electric service. . . ." (Appendix I, pp. 25, 26, Petition for Certiorari)

This holding was in accord with the principle that "The Courts cannot directly or indirectly exercise the rate-making power. . . ." *Hoover Motor Express* vs. *R. R. P. U. Commission*, 195 Tenn. 593, 605, 261 SW 2d 233, 238; and with the principle that the courts will not engage in "subjecting the merits of every action of statutory commissions and boards to judicial review, substituting the discretion of the Circuit or Chancery Courts for that of administrative bodies." *Anderson* vs. *City of Memphis*, 167 Tenn. 648, 72 SW 2d 1059; *Savage Co.* vs. *Knoxville*, 167 Tenn. 642, 72 SW 2d 1057; *City of Nashville* vs. *Martin*, 156 Tenn. 443, 3 SW 2d 164; *Carriger* vs. *Mayor of Morristown*, 148 Tenn. 585, 256 SW 883.

FACTUAL ERRORS IN PETITION FOR CERTIORARI

The Petition for Certiorari makes mention of several figures, lifted from the voluminous record, and claims they were "ignored" by the City Commission. (Petition for Certiorari, pp. 4, 9) The figures mentioned by petitioners were dealt with at length by the Division's accounting witness, Carl White, National Director of the Utilities Division of Ernst and Ernst, Certified Public Accountants. (R. 442-471; Exh. 1 and 2, White; R. 436, 442).

Petitioners included in their "record" the judgment *pro confesso* of February 4, 1960, but did not mention the Order of March 3, 1960 which set aside the *pro confesso* as prematurely and improvidently issued. This order was entered by the Chancery Court while the case was pending in the appellate courts, and is not included in the record.

Petitioners state the fact (dehors the record) that the City now has a contract to purchase "cheap TVA power to be resold after 1959 . . .". (Petition for Certiorari, p. 3), but fail to add that the sales will not begin until 1962, and then at rates much higher than those available to ordinary distributors on the TVA system, and for limited volumes for peak period consumption only.

Petitioners state that one "city expert estimated 1960 loss of $6 million" at the old rates, while another "city expert estimated 1960 profit of $4,262,368." (Petition for Certiorari, p. 9). They fail to explain that the first expert was a witness testifying from the current studies made in the fall of 1959, while the second reference to a "city expert" is not to be witness in this case, but to an Economic Feasibility Report prepared in 1956 prior to commencement of construction of the City's $163,245,000 generating plant, estimating what the cost of power would be from the

proposed plant, assuming a much more favorable bond interest rate than was in fact obtained, and a higher rate of growth than was in fact experienced.

The Petition alleges (p. 9) that the "City of Memphis decided to finance future construction from cash without issuing further municipal bonds. . . ." No record reference is given, and none could be found. Except for ordinary renewals and replacements for existing plant, there has been no decision to finance future construction from cash.

CONCLUSION

The Petition for Certiorari fails to show that the Labor Council or its sixteen members have been deprived of any Constitutional rights or other rights, or that any Constitutional issue is involved in these proceedings, or that the Tennessee courts have committed any error whatsoever.

WHEREFORE, Respondents respectfully submit that the Petition for Certiorari should be denied.

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APPENDIX

Amendment to the Charter of the City of Memphis

By Private Acts Tennessee, 1939.
Chapter 381, House Bill 1264
Creating Board of Light, Gas and Water Commissioners.

SECTION 7: *Be it further enacted*, That said Board of Light, Gas and Water Commissioners shall have authority to make a schedule of rates for the several services and for different classes of consumers; and shall make such rates for the service rendered as will enable them at all times to pay operating expenses, interest, sinking funds, reserves for working capital, renewals and replacements, casualties and other fixed charges; but the rates charged users or consumers outside of the City of Memphis shall not necessarily be as low as the rates within the City. The said Light, Gas and Water Commissioners shall have the right to change the schedule of rates for both light, gas and or water in the City and outside the City, from time to time, as in their judgment may be necessary or proper; provided, that before any change shall be made in rates, the Board of Light, Gas and Water Commissioners shall be required to present an application to the Board of Commissioners of the City of Memphis, setting forth the reason for said proposed changes in rates, and said changes in rates shall not become effective until they shall have been approved by said Board of Commissioners, and provided further, that the Board of Light, Gas and Water Commissioners and the Board of Commissioners of the City of Memphis, shall prescribe rates that will be sufficient to pay all bonds or other indebtedness and interest thereon, including reserves therefor, and to provide for all expenses of operation and maintenance of said plants or system, including reserves therefor.

SECTION 17. Be it further enacted, That the Board of Light, Gas and Water Commissioners shall require that separate books and accounts be kept on the electric, gas and water operations, so that said books and accounts will reflect the financial condition of each division separately to the end that each division shall be self sustaining, and may require that the moneys and securities of each Division be placed in separate accounts.

SECTION 19. *Be it further enacted*, That the revenues received each year from the operation of the Light Division, before being used for any other purpose, shall be used for the following purposes, in the order named, to-wit:

(1) The payment of all operating expenses of the Light Division for the year.

(2) For interest accruals and sinking fund accruals on bonds and mortgages issued for the benefit of the Light Division.

(3) For cash payments to a working capital reserve, a renewals and replacement reserve, and a casualty reserves for the benefit of the Light Division, said cash payments to said reserves to be in such amounts as the Light, Gas and Water Commissioners think proper and by resolution elect to set up from time to time.

(4) For payment to the general funds of the municipality a sum equal in amount to what would be the City taxes on the properties of the Light Division within the City Limits of the City of Memphis if said properties were privately owned.

(5) For payment to a reasonable surplus account which may be used by the Board of Light, Gas and Water Commissioners for extensions and improvements to the light plant or system and or for the purchase of outstanding bonds that may have been issued for the benefit of the Light Division, as the

Board of Light, Gas and Water Commissioners may deem advisable.

(6) For payment to the general funds of the municipality a sum not to exceed a cumulative return of six per cent (6%) per annum of the equity or investment, if any, of the municipality in the properties of the Light Division, the said percentage to be fixed by resolution of the Board of Commissioners of the City of Memphis. Should the said percentage as fixed by resolution of the Board of Commissioners of Memphis exceed a reasonable figure in the opinion of the Board of Light, Gas and Water Commissioners, the amount to be paid by the Board of Light, Gas and Water Commissioners to the Board of Commissioners of the City of Memphis shall be determined by a Board of Arbitration, consisting of one member of the Board of City Commissioners and one member of the Board of Light, Gas and Water Commissioners, who shall elect a third member, and the findings of this Board of Arbitration shall be final and binding on both the Board of City Commissioners and the Board of Light, Gas and Water Commissioners.

Provided that in no event shall the aforesaid payment to the municipality for any year exceed one-half of the net profits realized by the Light Division during that year, unless the Board of Light, Gas and Water Commissioners shall, by resolution, consent thereto.

(7) Any surplus then remaining, over and above safe operating margins, shall be devoted solely to rate reduction.

It is further provided that said allotment of funds may be changed in such manner as may be deemed necessary by the Board of Light, Gas and Water Commissioners in contracting with the Tennessee

Valley Authority for the purchase of power, or as may be deemed necessary by the Board of Commissioners of the City of Memphis with the approval of the Board of Light, Gas and Water Commissioners in the issuance and sale of any bonds or notes on behalf of the electric system or on behalf of the electric system in conjunction with the gas or water systems.